



## REPORT TO THE UNIT HOLDERS IN THE ASPIRING FUND FOR THE MONTH JUNE 2019

<i>All returns are in NZ\$</i>	Returns			Return volatility	
	30 June 19	3 months	12 months	Since inception pa <sup>i</sup>	Since inception pa <sup>i</sup>
<b>Aspiring Fund</b>	<b>2.17%</b>	<b>3.92%</b>	<b>3.57%</b>	<b>10.98%</b>	<b>8.39%</b>
New Zealand Equities <sup>ii</sup>	3.79%	6.66%	17.42%	8.89%	11.24%
Australian Equities <sup>iii</sup>	1.67%	8.17%	6.31%	6.42%	15.54%
World Equities <sup>iv</sup>	3.45%	5.35%	6.93%	6.13%	12.70%

<sup>i</sup> February 2006, <sup>ii</sup> NZX50 Gross, <sup>iii</sup> ASX All Ordinaries Accumulated, <sup>iv</sup> MSCI World Equities Total Return

**Unit Price** **\$3.78**

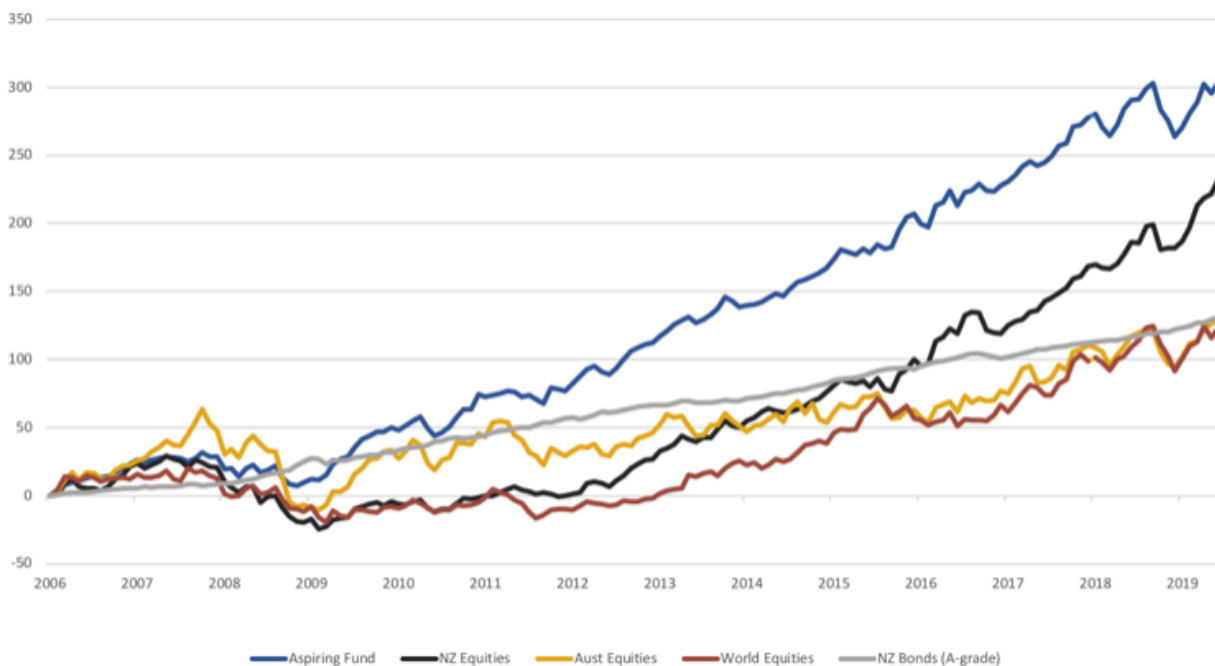
**ASSET ALLOCATION (approximately):**

New Zealand Equities	41.6%
Australian Equities	17.7%
International Equities	19.6%
Bonds	5.3%
Total Cash	15.9%
Short Equities	-0.1%

**Net Asset Value of the Fund (approximately):** **\$421.4m**

*The fund's main direct currency exposures at month end were - NZD 56%, AUD 22%, USD 18%*

## PERFORMANCE



*Aspiring Fund returns include all charges but are before tax expense, and exclude New Zealand tax credits. The returns of market indices shown above include capital returns and cash distributions, but reflect no deductions for trading and transaction costs, applicable tax, and other expenses. All return data is shown in NZD.*

The Fund returned 2.17% in June in what was a strong month for global equity markets.

With global growth stuttering, markets remain transfixed on the direction of interest rates and the global trade dispute. Both trended positively in June, and the MSCI World index responded with a 6.6% return. Equities continue to be spurred on by the TINA (there is no alternative) phenomenon, disregarding growth concerns implied by bond markets for now. In a month of little company specific news, our portfolios floated up with the general market rally.

The currency was a negative drag on performance to the tune of almost 1%. With a larger international position in the portfolio, currency movements will create more short-term volatility in the Fund's unit price. Over the longer term, which is the time span we focus on, this should even itself out. We will hedge our currency exposures in times where we believe specific currencies have moved outside a band driven by economics, but generally we maintain our international assets unhedged.

The New Zealand portfolio had a good month with our top defensive positions all carding strong returns. Spark (+4.8%), Tilt Renewables (+7.8%), Infratil (+11.9%), Contact (+8.5%), Z Energy (+5.0%), and Mercury (+20.8%) collectively contributed the majority of the Fund's June performance. While it would be nice to put this down to astute stock picking, the true story is that there was an absence of company news. Stocks simply melted up on the continuing recent theme of investors accepting increasingly lower dividend yields.

NZ market trading volumes remained thin and very sensitive to late trading into the closing auction on the last day of the month. Genesis Energy is an example. It rose 5% on the final day, with +40% of volumes put through on market close (typical of offshore investor trading). When sentiment does turn, the offshore program sellers are likely to be similarly unconcerned around best price on the way out.

Tilt Renewables was a NZ exception with its share price actually responding to new information. The company announced a review of their ownership of their largest asset, Snowtown 2 wind farm, in South Australia. We view the news as highly material as it shows management's focus on effective capital management and maximising shareholder value.

Our team was recently in Australia seeing senior management of a number of large corporates. A clear message was the increased focus on green (climate change) issues. Combined with the low cost of capital environment and demand for defensive long duration cashflow businesses, we believe this corporate green intent could potentially see the sale of Snowtown 2 act as an important valuation marker. When including our Infratil position, Tilt represents approximately 3.92% of the Fund.

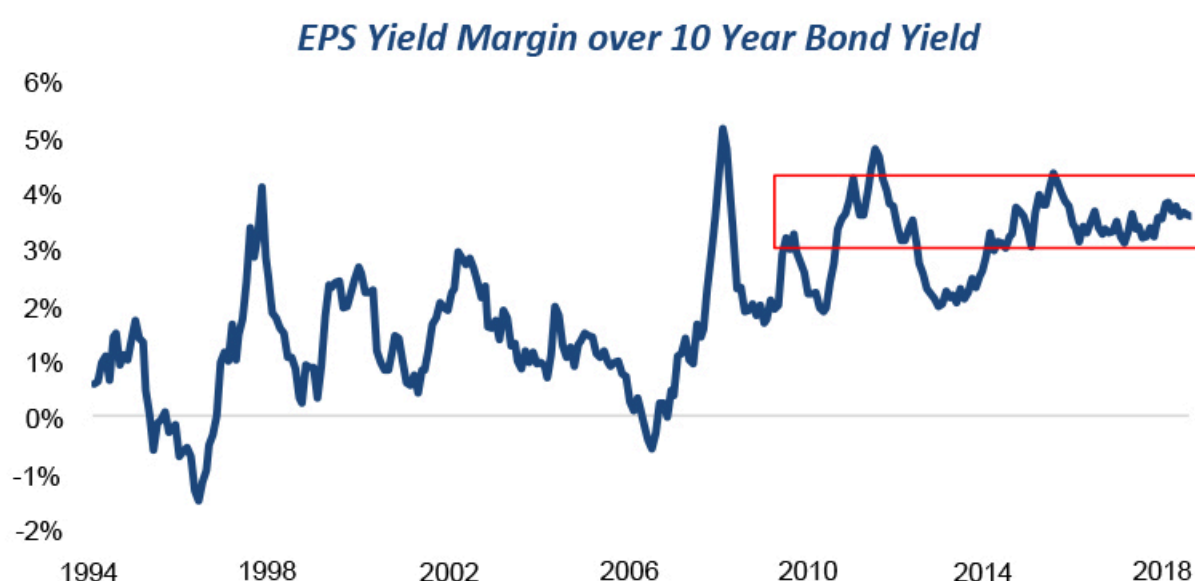
The recent melt-up of defensive yield stocks has underpinned a sharp re-rating of the average price/earnings (PE) multiple of NZ shares. As the chart below highlights, our estimate of the current average PE ratio is an unprecedented 19.5x (this average PE excludes loss makers and property developers).



Why has this rerating occurred? The following table breaks down the components of this PE ratio change since December 2018. With the rise in the PE ratio from 16x to 19x, the average earnings yield of stocks has fallen from 6.2% to 5.1%, a 1.1% change. Over the same time period, the NZ 10 year bond yield has fallen from 2.4% to 1.5%, a 0.9% change. As a result, stocks earnings yield premium to bond yields (the risk premium) is broadly unchanged at ~3.5%.

	PE (Price / Earnings)	EPS yield (Earnings / Price) (a)	Bond Yield (10 Year) (b)	Yield Margin (a-b)
Dec -19	16.2	6.2%	2.4%	3.8%
Jul -19	19.5	5.1%	1.5%	3.6%

What is remarkable, as the following chart shows, is this ~3.5% risk premium has been consistent since 2009. Bond yields have, and continue to be, the price setter for NZ shares in this investment cycle.



With record low earnings yields and lower growth (as implied by long bond yields now at the rate of inflation), NZ shares are now priced for low long-run future returns (returns = earnings yield plus earnings growth). Referring back to the table, investors in NZ Equities have lost a 1% pa return from the reduction in yield this year. As such we continue to believe offshore diversification in markets with higher yield spreads, is the best course of action for our fellow investors' money.

The largest headwind in the NZ portfolio was a2 Milk (-7%), which fell 11% at the start of the month after China released a plan to promote domestic infant formula. While this will likely result in increased competition for a2 over time, their long-standing joint venture with Government owned China State Farms provides comfort that they will continue to sell their product in China free of new impediment and that their success will continue to depend on the strength of their brand, as perceived by the Chinese consumer.

Our Aussie portfolio had a strong month, in line with the Aussie index return. Our largest tailwind was from waste management company Bingo (+22.5%) on no specific news. The stock soared in the middle of the month, coinciding with an initiation from an Aussie broker highlighting significant upside to the share price on Bingo's perceived ability to lift pricing in NSW, where it has ~50% of the available landfill capacity. We also had decent wins in miners BHP Billiton +9% and Fortescue +12% as the impact from the Vale dam disaster and Aussie weather disruptions squeezed the Iron Ore price to 5-year highs. We took the opportunity to bank profits on all of these names through the month.

The biggest headwind was retirement village operator Aveo Group (-12%), whose sale process dragged on through June with the announcement that Canadian buyout fund Brookfield was the last remaining contender for the business. We have been long suffering shareholders in the company, believing that the thematic of long term growth in retirement villages and the discounted pricing of the stock justified this position. However, a disappointing earnings update from the company has finally tested our patience, and we reduced our holding over the month. We remain hopeful of a positive outcome with early July reports talking of an imminent deal.

Our international portfolio produced a strong absolute return, although we were outpaced by rampant offshore markets. Our best performers were Amazon +6.7%, Alibaba +13.5% and copper play Freeport McMoRan +19.6%, however it was the macro driven rally rather than company specific news which spurred these names on.

Recent visits to two of our UK listed positions, Autotrader and Fever-tree, confirmed the underlying investment thesis behind both of these stocks. Autotrader is the dominant online classified advertiser for used and new cars in the UK market. The UK has over 34.9m cars on the road with over 7.9m used car transactions and over 2.4m new car registrations annually. Autotrader's dominant market position gives the company strong pricing power and the expansion of its data and digital services provides opportunities for strong revenue and profit growth.

Fever-tree was started 10 years ago and has essentially invented the premium mixer market. In the UK, premium mixers have now taken over half of the market – a phenomenal marketing and branding success. The company is well positioned to at least partially replicate this success in the far larger European and North American markets.

Whilst Autotrader and Fever-tree operate in very different markets they share a common thread. Both have very capital-lite business models which allow them to generate fantastic returns on capital and throw off enormous amounts of free cash flow without the use of financial leverage. We are confident that both companies will be great compounders of shareholder wealth over time.

## Top 10 Holdings

Spark	4.2%
A2 Milk	3.6%
TILT	3.5%
Infratil	2.7%
Amazon	2.7%
Contact	2.5%
Z Energy	2.2%
Mercury	2.0%
Google	1.9%
Cleanaway	1.5%

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